RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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March 25, 1987 **LETTER 961**

March 13 DJIA 2258.66; PTI 2573; A-D Ratio -3.61
March 20 DJIA 2333.52; PTI 2589; A-D Ratio -3.20

THE MARKET: Year after year I have repeated that "this is a primary bull market," and therefore our investment stance is to "give the bull market every benefit of the doubt -- we sit with 'em and buy more on declines." Over and over again, through corrections, shakeouts, news scares, and program-selling sprees, that policy served us well. Each time, following a decline or a correction, the Averages rallied back over the previous highs and the bull market was reconfirmed.

But in Letter 959 I stated that because this bull market was overbought, overextended, and overvalued, I was going to alter our policy. Instead of automatically giving the bull market every benefit of the doubt, I would ask the bull market to "prove itself over and over again."

Prove itself? How can we ask a bull market to prove itself? It can be done, and here's how. Each time the market sells off, each time the market declines, I'm going to be nervous. And I'm going to remain nervous until the Averages (i.e., the D-J Industrials and Transports) rally back above their previous highs. If one or both Averages fail to better their previous highs, I'm going to be suspicious. What's more, I'll remain suspicious until BOTH Averages rally above their preceding highs again.

Actually (in line with our new policy) we should probably welcome any market decline. Why? Because each decline will provide us with a new opportunity to confirm and reconfirm the primary bull trend. And right now we have a perfect opportunity to put our new policy to work.

Referring to the current situation, bull market highs for the Averages were recorded on March 6 with the D-J Industrials at 2280.23 and the D-J Transports at 958.21. Following a two week decline, the Industrial Average (on March 17) surged well above its 2280.23 peak. But the Transports lagged (i.e., failed to confirm). As of this writing, the Transports are still well below their March 6 peak of 958.21. From the standpoint of the continuance of the bull market, it will be most important to see how the Transports act from here.

If the Transportation Average can better its 958.21 peak in the period ahead, then we will have received another "all-clear" signal from the market -- in which case I would expect higher prices. On the other hand, a persistent refusal by the Transports to better the 958.21 high will be a signal that something is wrong. That "something" could take the form of a consolidation, a secondary correction, or even (in view of the overvaluation in stocks) a primary bear market.

At any rate, this is exactly what I mean when I say that I want the bull market to prove itself. And our new policy is in effect right now, as we watch to see whether the Transports can better their March 6 high of 958.21.

What about the Utility Average? I discussed the lagging Utility Average at length in the last Letter. The D-J Utility Average hit its high back on January 22 at 227.83. Since then the Utilities have been sliding, having lost roughly 10 points over the last few months. The decline in the Utility Average (in the face of the new highs in the other Averages) could be an early warning signal. Time will tell, but the Utility weakness is NOT something to be ignored.

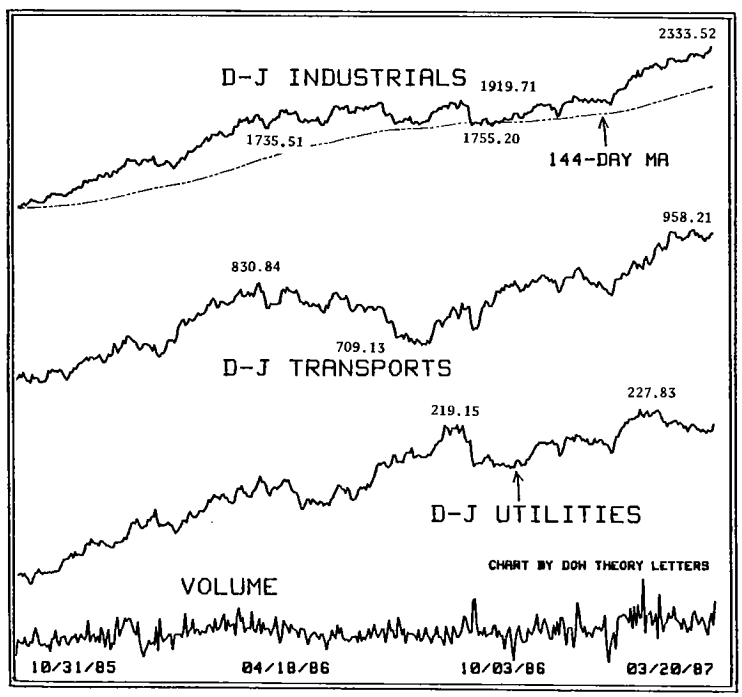
I look at the 1987 picture this way: the bull held the market in its grip all during January and February. On March 5 the A-D ratio struck a bull market high of minus 3.44 (see page 2 chart). The next day marked the beginning of the bear's attack. The bear's attack during the period of March 6 to March 16 was LACKLUSTER. In fact, during that period my PTI (see page 2 chart) continued to climb to new record highs.

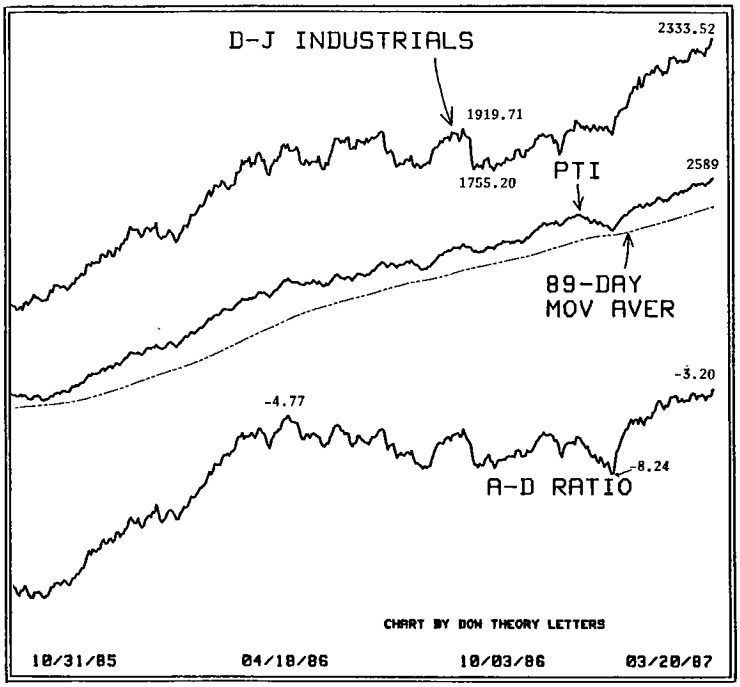
On March 17 the bulls took over again, and on that day the Dow surged to a new record high. On the same day new highs were recorded by both the NYSE Composite and the S & P 500. Except for the non-confirmation by the Transportation Average and the lag in the Utility Average, it would appear that the bull is still in control of Wall Street.

Question: With Japan pouring huge sums of money into the US market, how could we have trouble here?

Answer: Every bull market has its own brand of idiocy. This one seems to be thriving on the thesis that the US market is "a bargain compared with Japan's market" and therefore the cash-rich Japanese have nowhere to put their money except into US stocks and bonds.

The fact is that the Japanese index is selling at a P/E ratio of around 50. Japan's stocks are ridiculously overpriced, and consequently we're supposed to believe that the major US stock averages will also climb to 40 or 50 times earnings. But what about the chances of trouble hitting the Japanese market? What about the possibility of the Japanese stock market collapsing to meet US P/E ratios? Frankly, I think there's a good chance that trouble in Japan could be the next item on the international financial menu.





In view of the historic rise and overvaluation in the Japanese stock market (the average Japanese stock now yields less than 1%) I thought the following was well worth reading. It was written by my good friend, Robert Powers of Powers Investment Service (770 B St., Suite 424, San Diego, CA 92101):

"ASIAN FEVER: On Feb. 9, 1987, Nippon Telegraph and Telephone was listed on the Tokyo Stock Exchange. Within one week it had risen 47%. In a strong stock market, it is not uncommon for a new issue to rise 47% in value within one week of its initial public offering. However, Nippon Tel & Tel has a market value of about $180 billion, which is approximately equal to the COMBINED market value of IBM, General Electric, American Telephone, General Motors, and Eastman Kodak. Furthermore, Nippon Tel & Tel derives 83% of its revenues from a very mature business -- the telephone business. If American Telephone, the US counterpart of Nippon Tel & Tel, were to sell for a comparable price-earnings ratio, it would sell for $250 a share instead of its current price of $23 a share. Such is the level of speculation in the Japanese stock market. To try to slow the frothy market activity, the Japanese authorities recently raised margin requirements to 70%, but the beat goes on. On April 1, 1987, the program traders and portfolio insurers will be able to do for the Japanese stock market what they have done for the US stock market, as stock index futures on 50 big cap Japanese stocks will then start trading on the Osaka Stock Exchange."

Primary Trend: I want to go over the whole concept of the primary trend once more. Please understand this -- the single most difficult thing to get across to subscribers (and this includes many of my veteran subscribers) is the concept of the primary trend.

To put it simply, the primary trend is the great TIDAL FORCE, the force that overrides every other consideration in the market. When the primary trend turns up, stocks will rise and continue to rise until the power of the bull market is fully expressed. When the primary trend turns down, stocks will decline, and they will continue to decline until all the bearish forces are fully expressed.

Question: How do we know if or when the primary trend has reversed?

Answer: Surprisingly (and unfortunately) there is NO WAY OF KNOWING AT THE TIME that the primary trend has reversed. The turn in the tide can only be known with certainty AFTER THE EVENT.

You can guess, you can infer, you can use your crystal ball, and you can use all kinds and varieties of technical and fundamental studies -- but there is NO WAY of pinpointing the exact day or even the exact week of a primary reversal.

Let me give you an example: the D–J Averages recorded bull market highs on September 3, 1929 -- Industrials at 381.17 and Rails at 189.11. That was the PEAK, the ultimate high day for the 1921-29 bull market. Yet there wasn't a man alive who could have known that at the time. I can almost guarantee that nobody even suspected that September 3, 1929 was THE high day for the great bull market.

The fact is that most of the investment world was bullish on the market all during the year 1929, they were bullish all during the month of September 1929 and they were bullish on the top day of September 3, 1929. True, a few brave souls had turned bearish earlier. Roger Babson had written bearishly as early as 1928. Bernard Baruch had warned his friends and sold a good deal of his own stock by mid-1929. Joseph Kennedy was short the market during September. William P. Hamilton, editor of the WSJ, had issued numerous warnings in both the Journal and in Barron's. But nobody, repeat, NOBODY, knew for certain in late-1929 that the great bull market was finally on the verge of a fatal heart attack.

During September 1929 the Averages sold off, then rose into October (but not to new highs), then sold off again. It was NOT UNTIL LATE OCTOBER that the news was out. Hamilton, in his famous "Turn of the Tide" editorial of October 25, 1929 (it appeared on the front page of the WSJ) stated that according to the Dow Theory, a primary bear market was in force.

Were there any hints at the September highs that the primary bull market was about to die? Sure there were, but the hints were no more apparent in September than they were in June, July, or August of 1929. In other words, the bears during late-1929 saw the trouble brewing, they saw the overvaluation, they saw the frenzied speculation, they saw the "New Era" psychology. But the death of the bull market was only seen IN RETROSPECT -- after the Dow Theory had signaled that a primary bear market was in force.

Now this is very important. Once the primary trend turns down, the bearish tidal force takes PRECEDENCE over every other consideration. A primary downturn means that the highs for the stock market have been seen. New highs in the short interest, a drastically oversold market, new peaks in odd-lot short selling, extremes in investor pessimism, NONE OF THESE will revive the bull market. And none of these will take stocks to new highs.

In a bear market, the best that an oversold condition will do is to set off a market rally. But when the rally fizzles, new lows in the Averages (and in most stocks) will be seen. That's the way bear markets work (and, of course, bull markets work in exactly the opposite way).

So you can see that my main concern in this market is to see whether the Averages, once they dip, can turn up and gather the strength to BETTER THEIR PRECEDING HIGHS. That's our ACID TEST of the direction of the primary trend.

Question: Is there any correlation between fundamentals and market timing?

Answer: Despite what you may hear, the answer is yes. I'll explain. Every bull market is divided into three psychological phases (these phases are based on investors' sentiment, NOT price action). The first phase of a bull market represents the initial bounce up from the depressed lows of the preceding bear market. Here stocks go from extreme undervaluation back to known values.

The second phase (often the longest) sees stocks advance as they reflect improving business and the brightening psychology of investors.

The third and final phase of a bull market is the one in which stocks rise (amid great froth and speculation) to levels of overvaluation. It

is somewhere during this third phase that the next bear market will begin.

It is important to remember that bear markets are born ONLY during the excitement and froth of the THIRD PHASE of a bull market. So the critical question becomes, "How do we identify the third phase of a bull market?"

One of the dominant characteristics of the third phase is OVERVALUATION. And it is here that fundamental (value) considerations are critically important. I have gone over the current third phase overvaluation situation in all the recent Letters. And, of course, I'm referring to the yield on the Dow, the price/earnings ratio for the Dow, and the book value for the Dow. All of today's fundamental statistics for the Dow (and for the market in general) suggest that this bull market is now deep into its third phase.

So this is the connection between fundamentals and timing in the stock market. Valuation fundamentals are crucial in IDENTIFYING the phase of a bull market that we are in. And again, we must remember that it is ONLY in the third phase of a bull market that the seeds of the next bear market are sown.

Speaking of fundamentals, many older subscribers probably remember the great work pioneered by Edson Gould some years ago. One of the instruments Edson used in gauging the market was his Senti-meter. This was Gould's illustrated gauge of Dow yields cleverly correlated with market sentiment. Fred Hollander of Bache Securities has simplified the Senti-meter. I've updated it and I show it at the end of the Notes & Quotes section(see page 5).

Question: Some bull markets top out and simply erode away into bear markets. Other bull markets top out and then crash. What is the cause or the difference in the two phenomena?

Answer: The more common ending for a bull market is the erosion type of action. An early bear market crash is actually a rare phenomenon. The eroding type of bear market occurs when the stock market, during a period of relative prosperity, looks ahead and sees a business downturn. The bull market, sensing the negative picture ahead, turns down and at that point the bear takes over.

In a few rare instances (for instance, 1929 and 1937) the stock market continues to indulge in wild speculation DESPITE the fact that the economy has ALREADY TURNED DOWN. In other words, for reasons of its own, the stock market chooses to diverge with the deteriorating business picture. Then, when the stock market finally "decides" to face reality, it finds itself HAVING LAGGED FAR BEHIND the true economic picture. Such conditions can lead to a crash as the market rushes to get in harmony with the actual business conditions.

Question: I note that many analysts are now justifying the high multiples for the various averages on the basis of inflation-adjusting. For instance, a number of chart services show the Dow level (adjusted for inflation) at around 750. Under this line of thinking, the Dow and most of the other averages still look cheap. What do you think of this approach?

Answer: This is one of the commonest bull arguments, and I believe it is sheer nonsense. One of the basic tenets of Dow Theory is that the Averages ADJUST FOR EVERYTHING. And that means that the stock averages adjust to the danger of war, oil shortages, oil surpluses, rising dollars, falling dollars, presidential blundering, rising or falling gold prices, rising or declining interest rates, new tax laws, computer buy/sell programs, and a thousand other items INCLUDING INFLATION.

No, the averages don't need adjusting for any one particular item or phenomenon, and those who insist on adjusting the stock averages for inflation are simply creating a deception.

The deception is obvious -- the deceivers are attempting to make the stock market look like a bargain instead of the overvalued vehicle that it now is. I wonder if, during the next bear market, these same people will adjust the averages for deflation, thereby making the decline (or collapse) appear less precipitous than it probably is fated to be!

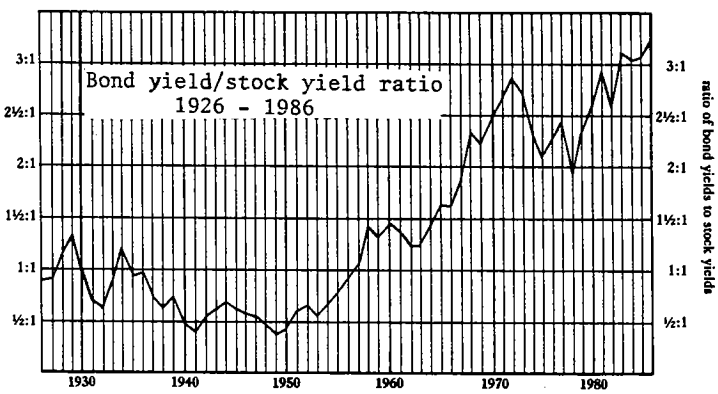
INVESTMENT POSITION: The PTI is at new highs, as are most of the major averages. Our one-horned bull stays in the box, because this is STILL A BULL MARKET. The bull's missing horn is my way of showing that this market is both overextended and overvalued. A one-horned bull can be wild and crazy, but he hasn't got the fundamental power of a bull with two horns.

In recent Letters, I've been talking about taking some profits, and as you know it's the first time in years that I have talked this way. At this point I would like my subscribers to have about 75% to 80% of the amount of stocks (in dollar value) that you started out with in 1987. If this market works higher, we will cut back further.

This bull market gives at least the appearance of going wherever it's going without so much as a 10% intervening correction. In the whole history of the stock market that's never happened before, but then man had never gone to the moon before, and the US had never had a $140 billion negative trade balance before. As a point of interest, the YIELD on S&P 400 Industrials is now down to 2.5%, the lowest yield in the history of this index.

Despite many forecasts to the contrary, bonds have continued to act well. My own opinion is that when the next downturn in the economy occurs, the authorities (both here and abroad) will do everything in their power to bring interest rates DOWN. That could bring on the final rise in bond prices (although I am definitely not including junk bonds in this prediction -- I think junk bonds will be history in the next bear market).

BONDS: One of the most informative reports around is Jim Grant's "Interest Rate Observer" (233 B'way, NYC 10279). In his latest issue, Jim publishes a chart by Paul Montgomery (analyst for Legg, Mason out of Newport News, VA). I include the chart here. It is simply a ratio of bond yields to stock yields going back into the 1920s. Note that the ratio is now better than 3 to 1 in favor of bond yields.



Note the collapse in this ratio from the 1929 peak to the 1941 low. This was a period of deflation or non-inflation, and during most of this period there was a great mistrust of common stocks (due to the trauma of the1929 and the 1937 crashes). Beginning in 1949 the ratio began climbing as inflation increased and as the cult of equities gradually took over the public mind.

My view: Note that we are now in the third wave of the rise in this ratio. When this wave tops out we will see a major reversal as equities lose out in favor of the high yields and safety of bonds.

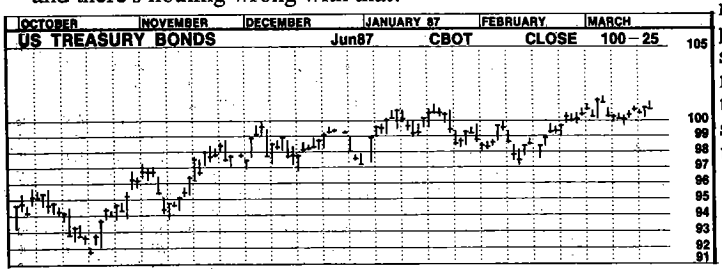
Info: For those wanting attractive yields and not knowing where to go, here's a suggestion -- look at the area of UTILITY BONDS. Many utility bonds are yielding more than the preferred stocks of the same companies (the reason being that the preferred are very desirable to corporations, since corporations enjoy an 80% dividend tax exclusion on preferred income).

Better-grade (A- or AA-rated by S&P) utility bonds now yield anywhere from 8.5% to 9%, and I consider this area one of the safest and most attractive for yields at this time.

I like a book that has just been published, "Buying Municipal Bonds" by John Andrew (Free Press, $17.95). Lots of good info on muni bonds; lot's of dos and don'ts. Here an excerpt: *"In ancient Greece, Hippocrates gave this advice to physicians: 'First, do no harm.' To invest wisely, follow this advice: 'First, lose no money.' The best way not to lose money is not to try to make too much money. If you try to get rich in a hurry, you will invariably take on more risk than is prudent.*

"Making just 3% or 4% --after inflation -- on your investments is nothing to be ashamed of. Many professional money managers don't do as well. While it's fine to shoot for a little more than that -- and you can do it sometimes with municipal bonds -- just 3% to 4% is a worthy goal. It may not sound like much, but over time the power of compound interest will do its work. And you'll only be taking minimal risk."

The chart of the June T-bond contract shows the bonds pushing against the 102 ceiling. Big support appears at 97. As I've been suggesting for months, the bonds are stuck in a high trading range -- and there's nothing wrong with that!



SDI: Is the Strategic Defense Initiative just a mountain of nonsense, a military dream, a plan to spend America into bankruptcy? Or does the whole SDI concept make sense? Robert Jastrow (author, professor, founder, Goddard Inst. for Space Studies) is one of America's most brilliant scientists. Here's what Jastrow says about SDI (from a recent article):

> **"Deploying ground-based defenses without a space-based layer also would be tantamount to handing military control of space over to the U.S.S.R. We know Soviet scientists are working very hard on lasers to destroy satellites in orbit. They also are working on lasers as a boost-phase defense against American ballistic missiles.**
>
> **If we do not press forward as rapidly as possible with our own space-based defense, by the late 1990s the Soviets will be in a position to disrupt United States communications and reconnaissance satellites at will. By the end of the century, they may be able to keep the United States out of space altogether. They'll close the door and say, "You can't come in."**
>
> **We no more can survive as a nation without a military guarantee of free access to space than we could survive without a military guarantee of access to the world's oceans. We need space-based defenses as much as we need the United States Navy. That is why Soviet leader Mikhail Gorbachev was so insistent on killing the space-based part of SDI in Reykjavik, and why the President was so insistent on preserving it."**

A close friend of Bob Jastrow's and one of my closest high school buddies is SM Keeny, president of the Arms Control Assoc. and former director of the US Arms Control and Disarmament Agency. Keeny disagrees 100% with Jastrow. In a recent article, Keeny states that this Administration wants to stir up such Congressional and public support for SDI that the program will be virtually unstopable, and future administrations will therefore be locked into the SDI picture. Says Keeny, pursuit of SDI will destroy any lingering prospects for progress in arms control under Reagan. ... If the plan should succeed, Reagan's legacy will be a major acceleration in the strategic arms race, vast new military demands on the budget, and a major reduction in US security. I include an excerpt from the Keeny piece below:

"The new systems for early deployment are technically flawed for exactly the same reason as the earlier versions. The satellites in the first layer and any radars controlling the second and third layers would be extremely vulnerable targets, and there is little likelihood the system would survive long enough to perform. The first layer could easily be defeated by Soviet deployment of shorter-burn boosters. The second layer would easily be overwhelmed by decoys, for which no satisfactory means of discrimination will even in principle be available. The ability of the final stage to operate at all in a nuclear environment is questionable. There is no prospect that such a system will meet the Administration's own criteria for deployment: technical feasibility, survivability and cost-effectiveness at the margin. Little wonder the Joint Chiefs are unwilling to support a deployment decision at this time."

So Keeny believes that SDI represents a menace to world peace and that the Reagan approach represents "the end of the 30 years of efforts to control nuclear arms by six previous Presidents starting with Eisenhower."

What's the true answer? My own belief is that THE answer lies with the INTENTIONS of the leaders of the US and Russia. Does Russia want to expand world communism at any cost (via the vast military power of the Soviets)? Does the US need its military build-up to defend itself against Russia -- or does the US need its military build-up to insure that its economy won't collapse? Or has the military build-up on BOTH sides become so colossal that it has taken on an cancerous life of its own?

Those are questions I can't answer. I don't trust Reagan's intelligence or analytical ability, and I don't trust the Russians' intentions. Jastrow and Keeny are both brilliant and extremely well informed and they don't agree. One question does haunt me. Jastrow claims that the Russians are going full speed ahead on their own version of SDI. If that is true, then the SDI supporters are right.

NOTES & QUOTES: The Japanese have the Puritan ethic. They save about 20% of their disposable income. The US savings rate (as a percentage of disposable income) was just over 6% in 1984. It dropped to 5% in 1985. In 1986 it was down to a mere 3.8%. But in the fourth quarter of 1986 the US savings rate sank to a minuscule 2.5%. What's happening? For one thing, the bull market in stocks and bonds has caused many young Americans to feel "rich." Consequently, they go out and "shop 'till they drop." Also, with the new low interest home-equity loans, thousands of US consumers have borrowed on a portion of their real estate appreciation, and they then go out and spend the money. Thus, some economists believe that the US could now be heading for a NEGATIVE savings rate. In other words, for the first time, US consumers as a group could be about to spend more than their entire income.

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Facts: The US Senate has only one professional economist: Phil Gramm (R, TX). ... Of the 100 men and women in the US Senate, 60 are lawyers. ... In 1966 there were 70,906 lawsuits filed in federal courts. In 1986 the volume had more than tripled to 254,828. One reason for the insane rise in lawsuits. Judges today have much less respect for precedent law. Judges (hoping to make legal history) continue to think up novel legal doctrines, thus encouraging the US's 650,000 lawyers to take an ever-increasing number of cases to court. Furthermore, the old idea of "legal

restraint" is out the window. Today judges and lawyers believe that everything can be decided in court.

* *

The folklore says that all new financial fads start in the east and work west. Conversely, all new social fads start in California and work toward the east. If so, the US auto picture is interesting. In 1986 in California new car registrations were as follows (ranked by number of cars registered): (1) Honda Accord, (2) Honda Civic/CRX, (3) Nissan Sentra, (4) Hyundai Excel, (5) Ford Tempo, (6) Toyota Camry, (7) Toyota Corolla. But nationally the story was far different. Here are the national 1986 best sellers: (1) Ford Escort, (2) Chevrolet Celebrity, (3) Chevrolet Cavalier, (4) Olds Cutlass, (5) Honda Accord, (6) Ford Tempo, (7) Ford Fiero.

In California 6 of the top 7 auto sellers were Japanese. Nationally, only one was Japanese. If California sets the trend, the US auto industry is in trouble.

* *

Last week's issue of People magazine contained an excellent and frightening interview with Surgeon General C. Everett Koop. Somehow, the enormity of the AIDS disaster hadn't hit me until I read this piece. I thought a few excerpts from the piece were well worth including here. Koop states: "In the US we believe that by the end of 1990 there will be 170,000 dead, with 54,000 dying in that year and another quarter of a million will have been diagnosed. We expect between 50 and 100 million deaths worldwide by the early years of the next century. Ninety-one countries have already reported AIDS."

How can people protect themselves against AIDS?

Let me make this clear. If you go to your partner and say, "I want you to come and have a blood test today," and you stick with him for the next three months, that doesn't help you one bit. He could have been contaminated as long as six months ago. But his test might not show up yet, and that false negative creates a feeling of complete security. The test could turn positive as early as two weeks—unlikely; by three months—unusually; by six months—usually. You've got to keep your eye on him all the time. That's why it's so important to stick to a mutually faithful monogamous relationship.

Might the country eventually quarantine known AIDS carriers?

How are you going to find the people to quarantine? You would have to test the entire population, 240 million people. Suppose you found three million carriers of the AIDS antibodies, what are you going to do to them? And why? And is it fair? Suppose in that group of three million you have 1,000 irresponsible people who are spreading the virus; should all the others be locked up for the rest of their lives?

How soon do you expect a vaccine?

It took 17 years to develop a vaccine against hepatitis B, and my virology friends tell me that was an easy virus to understand in comparison to this one. I don't see a vaccine in the foreseeable future. □

* *

Looking for a growth industry? The stock market, with its cold, emotionless logic, appears to be preparing for the coming AIDS plague (and I'm serious). I include this clip from the March 12 Investor's Daily. Note No. 1! Hillenbrand, by the way, is a major maker of caskets.

Groups With The Greatest % Of Stocks Making New Highs	
Funeral svcs & rel	50%
Auto mfrs-domestic	40%
Copper mining & milling	33%
Beverages-distillers	33%
Retail-jewelry stores	22%

* *

Here in La Jolla (at the University of California at San Diego) sits a super-computer -- one of the only 13 in the world. It is the Cray X-MP/48. This $14 million computer took nine months to build and contains 65 miles of wiring. To the left of the machine sit two operators and just outside their booth a sign is posted which states, "Please do not feed the computer operators." This computer performs 1,260 calculations a second -- a rate roughly 50,000 times faster than the best personal computer. In one minute the X-MP/48 can do what it would take an IBM PC ten days to do. The UCSD computer is so fast, says a local scientist, "that it changes the way people think." Hundreds of scientists in this area are using the computer. States one, "It is the computational equivalent to a trip to the moon."

* *

President Reagan may regain some of his former popularity, but things will never be the same. The bloom is off the presidential rose, and the public now perceives Reagan differently. What it sees is a well-meaning, bumbling, aging president, a man who is careless, lazy, and anything but a searcher. The president is still an excellent communicator, but few people believe at this point that he has anything to communicate. Personally, I feel that the rest of the Reagan presidency will be, more than anything else, a reflection of chief of staff Baker's ability to patch things up, prop Reagan up, and somehow keep the White House glued together.

* *

The guys in US heavy industry plants get wages of around $20 an hour, when you figure in benefits. In Mexico, just south of here, the wages run around 80 cents to a dollar an hour including benefits. In Hong Kong the going rate is $1.75 an hour (the word is that you can send any item to Hong Kong, and they'll duplicate it within two weeks). Now meditate on this -- wages in China run 40 cents an hour. And the Chinese are hungry (famished is more like it) for both profits and hard currencies.

Russell thought: Did you ever see a Chinese restaurant that wasn't open for lunch and dinner seven days a week? Did you ever note how hard they work in a Chinese laundry? OK, now watch the stores for an increasing amount of "made in China" merchandise. Economic common sense says the "Chinese invasion" is on the way.

* *

In the past year the number of blue-chip US stocks traded on the Tokyo exchange has doubled to 32 (IBM, Merrill, Disney, Amer. Exp., Dow Chemical, 3M, GM, P & G, etc). Volume in the 14 US stocks that have traded for a full year has jumped 186%.

* *

Are big-money investors always right? Not always. For instance, Carl Lindner and Marvin Davis recently bought $24 million worth of Aaron Spelling Productions (20% of the stock) at an average price of $14.22 per share. You can buy all you want of the stock now at $10.87. Lindner and Davis state that they bought the stocks because it was undervalued (Spelling produces such TV smash hits as Dynasty and Love Boat).

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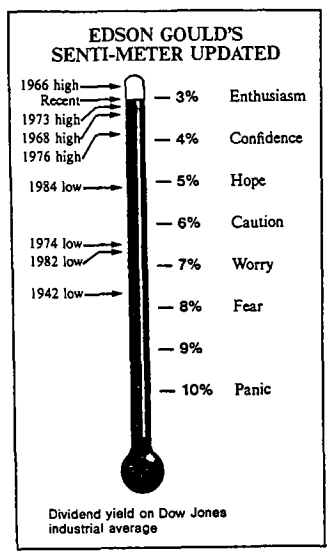


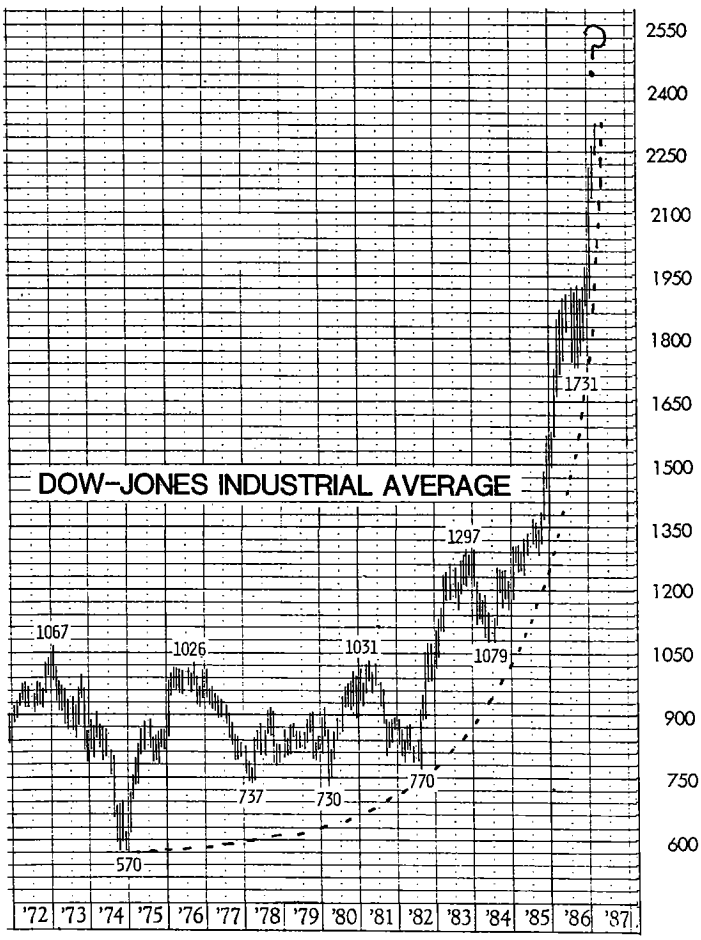
To get down to more mundane things, here is Edson Gould's updated Senti-meter, and it's worth studying. Any way you look at it, the stock market's temperature is RISING!

EXPONENTIAL: I have purposely placed the most critical part of this Letter near the end. Back in Letter 957 I wrote a piece on the three phases of a bull market. I stated that this bull market (like all others before it) has progressed in three phases. The first and second phases are basically investment phases. The third phase is basically a distribution phase. The third phase is the speculative,

frothy phase, the one that encompasses EVERYONE: the funds, the pros, the arbs, the gamblers, and the public.

I noted that this whole bull market since 1974 has taken the form of a great exponential rise. This is a rise that accelerates geometrically (i.e., at an increasing angle) -- until finally, the advance is climbing vertically or STRAIGHT UP. We are in the vertical phase NOW, as you can see on this chart! I might add that no one on this green earth can tell at what point an exponential rise will end (any more than you can tell, when you shoot a gun straight up, at what point the bullet will halt for a brief second and then turn down).

Obviously, we are currently in the most violent and exciting stage of the bull market. But there's one problem. The problem is that when an exponential rise ends, it almost always ends in a spear-point top and a subsequent collapse (as did gold in 1980). This is the REASON why I have recommended that my subscribers take profits as this bull market rockets up in its now literally vertical climb. Please -- study this chart carefully. Few people are aware of what's happening on Wall Street today and why. This chart, I believe, tells it all.



GOLD: The capitalization of all the Free World's gold mines is $37 billion -- S. Africa $17 billion, Canada $10 billion, the US $6 billion, Australia $4 billion. Canadian gold mines offer average yields of 1%, Australian 4.5%, and S. African 13.4%. In terms of pure value, the SA mines offer by far the most, since they not only have the largest stores of gold, but they use extremely conservative accounting methods (they write off all their expenditures in the year they occur).

Of 23 American gold funds, only four are now buying S. African shares, and this militates toward expensive N. American shares and cheap S. African shares. As far as owning S. African mine shares, Americans enjoy one big advantage over S. Africans: They receive their dividends in commercial rather than financial rands -- which doubles their yield. Now here's a little known fact: In S. Africa (with all the recent wage increases, it now costs an average of $215 to mine an ounce of gold, compared with $205 in N. America, although most of the mines in N. America are shallow vs. the deep rich ore veins of S. Africa).

Thus all in all, mining gold tends to be a very profitable business, since the markup on the product is near 100% at the current price of gold. It must be remembered that inflation in S. Africa is now running 17% (including rising wages), and this is a long-term negative for the S. African mines.

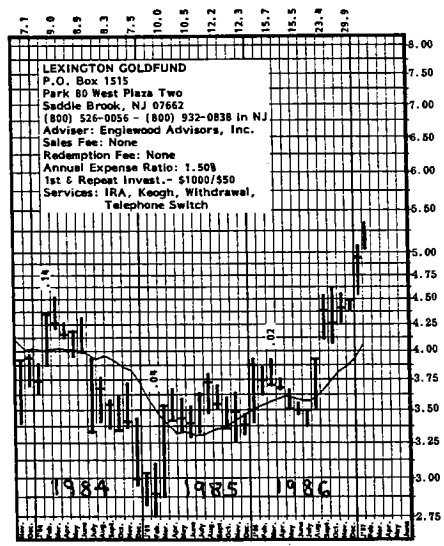
Why are Australian mines so infrequently purchased? First, the mines are mostly small, too small for institutional investors. Second, they are seldom written up or recommended for purchase by US advisory services. Finally, US investors associate Australia with socialism, and they hesitate to buy into that sort of environment.

How does one buy gold shares? To my mind, the simplest way to invest in gold stocks is via a mutual fund. I recently recommended the Lexington Goldfund (800-526-0056) at around 4.00 per share. The fund now sells around 5.37, but I still feel that this is a good way to invest in the gold shares. The fund is no-load, and I include a chart of it here (chart courtesy of Growth Fund Guide, Box 6600, Rapid City, SD 57709).

Gold has been walking above and below 400, showing no inclination to break out on the upside or the downside. Recently I heard Ed Hart (TV station FNN) say that gold bugs would rather make a dime in gold than a dollar in the stock market. And Ed wasn't far off the mark. I have not recommended gold for speculation — nor have I recommended gold for quick profits. I recommend gold for diversification, for safety, and as a hedge against inflation, war, destruction of the economic structure, a collapse in the banking system and any other disaster you can think of.

Personally, I am partial to the bullion coins such as the Krugerrand, the Maple Leaf, or the Coronas, but as I said I am not averse to buying a gold fund. Those who buy gold here must realize that it is early in the gold bull market and late in the stock bull market. So do not expect any explosion in the yellow metal here.

Buying gold here, if you want to look at it this way, is a bet that in the future our government will be as irresponsible as it has been in the past. That's what has driven gold up from $35 an ounce in the early 1970s to the current 400. That same irresponsibility will ultimately take gold to spectacular new highs.



LATE MARKET NOTES: Up and up she goes and where she stops nobody knows -- nevertheless, keep your eyes on the Transportation Average. The high was 958.21, and it hasn't confirmed yet. One other item: the A-D has risen 72% of the trading days during 1987 -- that's a super-lopsided figure.

NEXT MAILING: April 8